

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

ID No.

Telephone Number:

Refer Reply To:

CC:INTL:B05

PLR-113153-20

Date:

December 4, 2020

## LEGEND

|            |   |
|------------|---|
| X          | = |
| Parent     | = |
| Taxpayer   | = |
| Corp A     | = |
| FC1        | = |
| FC2        | = |
| Country A  | = |
| FC3        | = |
| Country B  | = |
| Y          | = |
| Date 1     | = |
| Policies A | = |
| Date 2     | = |
| Policies B | = |
| Date 3     | = |
| Amount 1   | = |
| Amount 2   | = |
| Amount 3   | = |
| Amount 4   | = |
| Date 4     | = |
| Z          | = |
| Date 5     | = |
| Date 6     | = |
| Amount 5   | = |
| Amount 6   | = |
| Date 7     | = |
| Amount 7   | = |
| Amount 8   | = |
| Regulator  | = |

Dear                   :

This is in response to your request for a ruling, dated X, that Taxpayer will not be treated as making a base erosion payment solely as a result of the proposed agreement between FC1 and FC2 described below.

## FACTS

Parent, a domestic corporation, owns all of the stock of Taxpayer, a domestic corporation. Taxpayer and Corp A, a domestic corporation, join in the filing of a consolidated federal tax return with Parent. All members of the consolidated group headed by Parent are calendar year taxpayers. Parent, Taxpayer, and Corp A are indirect subsidiaries of FC1, a foreign corporation. Parent, Taxpayer, Corp A, and FC1 offer insurance products and services. FC2, a foreign corporation, is an indirect subsidiary of FC1 that is organized under the laws of Country A. FC3, a foreign corporation, is a reinsurance company incorporated in Country B. FC1 owns Y percent of FC3. Neither FC1, FC2, nor FC3 has made an election under section 953(d).

Effective Date 1, Taxpayer entered into a reinsurance agreement with Corp A, with respect to certain policies written or assumed by Corp A. Under the reinsurance agreement, Corp A ceded, and Taxpayer agreed to reinsure, Policies A, for losses incurred prior to Date 2, and Policies B, for losses incurred prior to Date 3. Taxpayer received premium of Amount 1 in exchange for reinsuring Policies A up to a limit of Amount 2, and premium of Amount 3 in exchange for reinsuring Policies B up to a limit of Amount 4.

Effective Date 4, Taxpayer retroceded a Z percent quota share of Policies A and Policies B, along with certain other liabilities, to FC1 pursuant to a quota share reinsurance agreement.

On Date 5, Taxpayer entered into a quota share reinsurance agreement with FC2 by which Taxpayer retroceded and FC2 agreed to reinsure a Z percent quota share of Policies A (a different quota share interest than the Date 4 transaction, though the same percent) to FC2 ("Retrocession 1"). Retrocession 1 was effective as of Date 6. FC2 was entitled to premium of Amount 5 in exchange for reinsuring Policies A up to a limit of Amount 6. Taxpayer retained the premium as "funds withheld"<sup>1</sup> collateral to secure the reinsurance obligations of FC2; the funds withheld are separately accounted and FC2 is entitled to receive scheduled interest on the average funds withheld balance.

Effective Date 7, FC2 retroceded its Z percent quota share of Policies A to FC1, pursuant to a retrocession agreement ("Retrocession 2") under the same terms and

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<sup>1</sup> "Funds withheld" is defined in Retrocession 1 as the unencumbered funds and assets held in the U.S. and maintained in the exclusive possession and control of Taxpayer, initially consisting of the reinsurance premium, plus any subsequent funds and assets provided by FC2 as security for the payment by FC2 of the reinsured liabilities.

conditions as Retrocession 1, with an adjusted reinsurance premium based upon statutory reserves for Policies A as of Date 7. Also, effective Date 7, FC1 entered into a reinsurance agreement with FC3 by which it retroceded its Z percent quota share of Policies A ("Retrocession 3"). FC3 received premium of Amount 7 in exchange for reinsuring Policies A, up to a limit of Amount 8. As with Retrocession 1, the premiums with respect to Retrocession 3 are retained as original "funds withheld" collateral structure established by Retrocession 1, including scheduled interest payments on the withheld amounts.

To reduce operational complexity and administrative burden, Taxpayer, FC1, and FC2 propose to enter into an agreement ("Agreement") by which FC1 would be substituted for, and replace, FC2 as the direct retrocessionaire under Retrocession 1. The substitution and replacement would be approved by Taxpayer. Under the proposed Agreement, FC1 will accept and assume all rights, duties, liabilities, and obligations for the indemnity reinsurance under Retrocession 1, and FC2 will be released from its obligations and relinquish its rights to FC1. The proposed Agreement will restructure and replace Retrocession 1 and terminate and replace Retrocession 2. Under the proposed Agreement, FC1 will assume the liabilities of FC2 under Retrocession 1 as if it were the original party to Retrocession 1. Taxpayer will pay no new consideration as a result of the proposed Agreement. The proposed Agreement is subject to receiving regulatory approval from Regulator. Taxpayer represents that the obligations described in Retrocession 1 and the proposed Agreement constitute insurance for federal income tax purposes. Taxpayer also represents that Retrocession 1 is permitted to be accounted for as prospective reinsurance.

## LAW

The base erosion and anti-abuse tax ("BEAT") in section 59A was added to the Internal Revenue Code by the Tax Cuts and Jobs Act, Public Law 115-97 (2017), which was enacted on December 22, 2017. Section 14401(e) of Pub. L. 115-97 provides that the BEAT is applicable to base erosion payments paid or accrued in taxable years beginning after December 31, 2017.

Section 59A(a) requires an applicable taxpayer to pay a tax equal to the base erosion minimum tax amount for the taxable year. Generally, the base erosion minimum tax amount for the taxable year is computed based on the taxpayer's modified taxable income minus the taxpayer's regular tax liability under section 26(b) reduced by certain credits.

Section 59A(c)(1) provides that the applicable taxpayer determines its modified taxable income by computing its taxable income without regard to any base erosion tax benefit with respect to any base erosion payment or the base erosion percentage of any net operating loss deduction allowed under section 172 for the taxable year. Section 59A(d)(1) provides that a base erosion payment is any deductible amount paid or accrued by an applicable taxpayer to a foreign person (as defined in section

6038A(c)(3)) that is a related party of the applicable taxpayer. Under section 59A(d)(3), base erosion payments also include any premium or other consideration paid or accrued by the taxpayer to a foreign person which is a related party of the taxpayer for any reinsurance payments which are taken into account under sections 803(a)(1)(B) or 832(b)(4)(A). A base erosion payment does not include any amount paid or accrued in taxable years beginning before January 1, 2018. Treas. Reg. § 1.59A-3(b)(3)(vi). With respect to a base erosion payment described in section 59A(d)(1), section 59A(c)(2)(A)(i) provides that a base erosion tax benefit is the deduction which is allowed under Chapter 1 for the taxable year for the base erosion payment. With respect to a base erosion payment described in section 59A(d)(3), section 59A(c)(2)(A)(iii) provides that a base erosion tax benefit is any reduction under section 803(a)(1)(B) in the gross amount of premiums and other consideration on insurance and annuity contracts for premiums and other consideration arising out of indemnity insurance, and any deduction under section 832(b)(4)(A) from the amount of gross premiums written on insurance contracts during the taxable year for premiums paid for reinsurance.

Section 1.59A-3(b)(2)(i) of the Income Tax Regulations provides that “[t]he determination of the amount paid or accrued, and the identity of the payor and recipient of any amount paid or accrued, is made under general U.S. federal income tax law.”

Section 1.809-5(a)(7)(ii) of the Income Tax Regulations defines assumption reinsurance as "an arrangement whereby another person (the reinsurer) becomes solely liable to the policyholders on the contracts transferred by the taxpayer. Such term does not include indemnity reinsurance or reinsurance ceded."

An assumption reinsurance transaction is treated as a sale by the ceding company to the reinsuring company. *Beneficial Life Ins. Co. v. Commissioner*, 79 T.C. 627, 645 (1982), *nonacq. on other grounds*, 1984-2 C.B. 1.

## ANALYSIS

The proposed Agreement will operate as an assumption reinsurance transaction. An assumption reinsurance transaction changes one of the parties to the arrangement by relieving the original insurer of its obligations and allowing the obligations of the original insurer under the existing policies to be assumed by the reinsurer. Under the proposed Agreement, FC1 substitutes FC2 as the counter-party under Retrocession 1.

The proposed Agreement is treated as resulting in a sale by FC2 to FC1. As a result, any amount paid or accrued with respect to the proposed Agreement is occurring between FC1 and FC2. The change in the counterparty obligated to the taxpayer under a contract does not always result in a deemed termination of the contract as regards the taxpayer. Cf., e.g., Rev. Rul. 82-122, 1982-1 C.B. 80. The proposed Agreement does not result in a deduction for Taxpayer under section 832(b)(4)(A) from the amount of gross premiums written on insurance contracts during the taxable year for premiums paid for reinsurance. Additionally, the proposed Agreement will not alter the

dates the reinsurance premiums were paid under Retrocession 1, Retrocession 2, or Retrocession 3.

## CONCLUSION

The proposed Agreement does not affect Taxpayer's liability under section 59A. Thus, Taxpayer will not be treated as making a base erosion payment under section 59A(d)(3) solely as a result of the proposed Agreement. However, amounts paid or accrued by Taxpayer after the effective date of section 59A under or pursuant to the reinsurance agreements described in this ruling that meet the definition of the term "base erosion payment" under section 59A(d) and the regulations under section 59A will remain base erosion payments.

## CAVEATS

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

No ruling has been requested, and no opinion is expressed (or implied) whether Policies A are insurance contracts, Taxpayer is engaged in the reinsuring of risks underwritten by insurance companies, Taxpayer qualifies as an insurance company for Federal income tax purposes, or section 4371 is applicable to any transaction referenced in this letter.

No opinion is expressed regarding the date upon which the premiums are paid or accrued under Retrocession 1 for purposes of section 59A. No opinion is expressed regarding the tax treatment of any amount paid or accrued pursuant to the reinsurance agreements and with respect to the "funds withheld" described in this ruling, including, but not limited to, the amount, timing, and whether the agreements are priced at arm's-length.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the

material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

/s/ Peter Merkel  
Peter Merkel  
Branch Chief, Branch 5  
(International)

cc: